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Supreme Court, U.S.
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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1992

JAMES E. CROZIER, CHAPTER 11 TRUSTEE

Petitioner

v.

THERON BRADFORD, TRUSTEE

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE FIFTH CIRCUIT COURT OF APPEALS

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

WHETHER THE COURT OF APPEALS ERRED IN DETERMINING THAT 11 U.S.C. § 506(b) REQUIRES THAT AN OVERSECURED CREDITOR RECEIVE INTEREST AT THE CONTRACT RATE?

LIST OF PARTIES

The following persons are parties to this Petition for Writ of Certiorari:

James Crozier, Chapter 11 Trustee for the Bankruptcy Estate for Wayne Laymon

Theron Bradford, Managing General Partner of Bradford, Mayberry Properties, Inc. Group No. B-16

The following persons are limited partners of Bradford, Mayberry Properties, Inc. Group No. B-16:

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Otto Brandt
G. R. Ferguson
Diane Finch
John L. Fostor
Calvin Jayroe
Lewis Jennings
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PETITION FOR WRIT OF CERTIORARI

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

James E. Crozier, Petitioner, herein, prays that a Writ of Certiorari issue to review the

Judgment of the Fifth Circuit Court of Appeals entered in the above-entitled case on April 8, 1992.

OPINIONS BELOW

The Judgment of the Fifth Circuit Court of Appeals, which is herein sought to be reviewed, is reprinted in the Appendix to this Petition, page A-1. The Opinion of the Fifth Circuit Court of Appeals On Suggestion for Rehearing En Banc, which is noted at 964 F.2d 1145 (5th Cir. 1992), is reprinted in the Appendix to this Petition, page A-3. The Opinion of the Court of Appeals, which is published at 958 F.2d 72 (5th Cir. 1992) is reprinted in the Appendix at page A-5. The Order of the United States District Court is reprinted in the Appendix, page A-18. The Order on Motion to Reconsider and Trustee's Cross-Motion to Reconsider Order on Motion for Award of Interest, Costs and Fees Under § 506(b) is reprinted in the Appendix, page A-25. The Decision on Motion to Reconsider which is

published at 117 B.R. 856, is reprinted in the Appendix, page A-30.

JURISDICTION

The Judgment of the Fifth Circuit Court of Appeals was entered April 8, 1992. A timely Suggestion for Rehearing En Banc (which is also considered to be a petition for panel rehearing under the rules of the Fifth Circuit Court of Appeals) was filed on May 2, 1992. Panel rehearing was denied on May 21, 1992. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 502(b)(2):

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim

in lawful currency of the United States as of the date of filing of the petition, and shall allow such claim in such amount except to the extent that --

(2) such claim is for unmatured interest.

11 U.S.C. § 506(b):

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 726(a)(5):

(a) Except as provided in § 510 of this title, property of the estate shall be distributed --

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition,

on any claim paid under paragraph (1), (2), (3), or (4) of this subsection.

11 U.S.C. § 1129(b)(2)(A)(i)(II):

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) with respect to a class of secured claims, the plan provides --

(i)(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totalling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holders' interest in the estate's interest in such property.

12 U.S.C. § 1225(a)(5)(B)(ii):

(5) with respect to each allowed secured claim provided for by the plan --

(B)(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim...

11 U.S.C. § 1325(a)(5)(B)(ii):

(5) with respect to each allowed secured claim provided for by the plan --

(B)(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim...

28 U.S.C. § 1961(a):

(a) Interest shall be allowed on any money judgment in a civil case recovered in a district court. Execution therefor may be levied by the marshal, in any case where, by the law of the State in which such court is held, execution may be levied for interest on judgments recovered in the courts of the State. Such interest shall be

calculated from the date of the entry of the judgment, at a rate equal to the coupon issue yield equivalent (as determined by the Secretary of the Treasury) of the average accepted auction price for the last auction of fifty-two week United States Treasury bills settled immediately prior to the date of the judgment. The Director of the Administrative Office of the United State Courts shall distribute notice of that rate and any changes in it to all Federal judges.

STATEMENT OF CASE

A. Factual Background.

On August 18, 1983, Wayne Laymon ("Laymon"), the Debtor, executed a Promissory Note payable to Theron Bradford, Trustee ("Bradford"), in the original principal amount of $669,900.00. The Note was secured by a lien upon approximately 79.72 acres of real property located in Travis County, Texas. The Note provided for annual

payments in the amount of $66,990.00 for four years to cover accrued interest with a balloon payment due on August 24, 1988. The Note provided for interest at the rate of 10% per annum prior to default and default interest at the highest legal rate.

The Debtor failed to make the payment due on August 18, 1984. The Debtor subsequently filed a voluntary Petition under Chapter 11 on September 4, 1984.

In 1986, the Debtor made adequate protection payments to Bradford totalling $311,165.00. Subsequently, James E. Crozier ("Crozier") was appointed as Chapter 11 Trustee. The Trustee made additional adequate protection payments totalling $315,000.00.

B. Proceedings Below.

On May 8, 1989, Bradford filed a Motion Requesting Payment of Interest, Costs and Fees

under § 506(b) of the Bankruptcy Code. After a hearing on stipulated facts, the Bankruptcy Court denied Bradford's request for penalty interest, but allowed post-petition interest on the claim at the pre-default contract rate of 10%. It was stipulated at the hearing that Bradford held an oversecured claim.

Bradford filed a Motion for Reconsideration, and the Trustee filed a Cross-Motion for Reconsideration. After another hearing, the Court vacated its prior order and held that the Federal judgment interest rate of 28 U.S.C. § 1961(a) provided the proper measure of interest to an oversecured creditor. *In re Laymon*, 117 B.R. 856 (Bankr.W.D.Tex. 1990). The Bankruptcy Court relied upon this Court's holding in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989), which interpreted § 506(b). In *Ron Pair*, the Supreme Court held that

the phrase "interest on such claim" in § 506(b) was independent of the statutory language referring to fees, costs or charges provided for under the agreement. The Bankruptcy Court determined that interest under § 506(b) was not governed by the contract. 117 B.R. at 858, A-39. Therefore, the Court looked to Federal law to fashion an appropriate rate. After extensive analysis, the Court applied the Federal judgment rate, likening the award of post-petition interest to a Federal judgment. 117 B.R. at 859-65, A-43 to 69.

On appeal, the District Court affirmed, stating:

> The Supreme Court has construed the clear language of § 506(b) to indicate that an award of interest is separate and independent from "the agreement under which such claim arose." (citation omitted). The language of *Ron*

> *Pair* persuades the Court that the award of interest in a case such as the present one does not depend upon the provisions of the Note or Contract at issue.

A-23 to 24.

On April 8, 1992, the Fifth Circuit rendered an Opinion reversing the District Court. The Fifth Circuit relied upon this Court's holding in *Dewsnup v. Timm*, ___ U.S.___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). The Fifth Circuit determined that the legislative history to § 506(b) did not evidence an intent to change practice under the Bankruptcy Act. 958 F.2d at 74-75; A-13 to 14. The Fifth Circuit also ruled that under the Bankruptcy Act, the practice was to apply the contract rate. 958 F.2d at 75; A-14 to 15. Therefore, the Fifth Circuit reversed and held that the contract rate should have been applied. The Fifth Circuit remanded the case to the

lower Courts to determine whether the pre-default or post-default contract rate should be applied. 958 F.2d at 75; A-15 to 17.

On May 2, 1992, Crozier filed a Suggestion for Rehearing En Banc. Although a poll was requested by a member of the Fifth Circuit, a majority of the Judges did not vote to grant Rehearing En Banc. The panel considered the Suggestion for Rehearing En Banc as a request for panel rehearing and denied the request. A-3.

FEDERAL QUESTION RAISED

Pursuant to 28 U.S.C. § 157(b)(2) and § 1334, the Courts of the United States have jurisdiction over matters concerning claims in bankruptcy. When Theron Bradford, Trustee filed his Motion for Interest, Costs and Fees under § 506(b) on May 8, 1989, a Federal question was raised.

REASONS FOR GRANTING WRIT

Issue: Whether the Court of Appeals erred in determining that 11 U.S.C. § 506(b) requires that an oversecured creditor receive interest at the contract rate?

This case concerns the proper rate of interest to be paid to an oversecured creditor pursuant to 11 U.S.C. § 506(b). The Bankruptcy Court and the District Court held that 11 U.S.C. § 506(b) does not require payment of the contract rate to an oversecured creditor and applied the Federal judgment rate. The Fifth Circuit Court of Appeals reversed, holding that the contract rate should be applied based upon practice under the Bankruptcy Act.

Review is sought pursuant to Supreme Court Rule 10.1(c) which provides as follows:

.1. A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will be considered:

> (c) When a state court or a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way that

conflicts with applicable decisions of this Court.

Review by Certiorari is requested to interpret 11 U.S.C. § 506(b) in light of this Court's prior rulings in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) and *Dewsnup v. Timm*, ___ U.S.____, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). In *Ron Pair*, this Court ruled that the statutory language of 11 U.S.C. § 506(b) allowed interest to an oversecured statutory lien creditor, even though this changed practice under the Bankruptcy Act. In *Laymon*, the Fifth Circuit (relying on *Dewsnup*) held that an oversecured creditor with a contract was entitled to interest at the contract rate based upon prior practice under the Bankruptcy Act, even though the language of § 506(b) does not require interest at the contract rate.

Although this issue has not resulted in a split

of authority among the Courts of Appeals, it has produced a division among the lower Courts. Compare *Matter of Laymon*, 958 F.2d (5th Cir. 1992), *reh.den.* 964 F.2d 1145 (contract rate applied based upon Act practice); *In re Anderson*, 833 F.2d 834 (9th Cir. 1987) (contract rate applied without analysis); *In re Gladdin*, 107 B.R. 803 (Bankr.M.D.Ga. 1989)(no authority to modify contract rate); *Matter of Lauretti Corp.*, 86 B.R. 751 (Bankr.D.Conn. 1986)(contract rate applied but creditor could not enforce provision to increase contract rate post-petition); *In re Bates*, 58 B.R. 915 (Bankr.W.D.Tenn. 1986)(§ 506(b) refers to rate provided in agreement); *In re Loveridge Machine and Tool Company, Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983)(court did not rely upon grammar of § 506(b) but applied contract rate based upon equitable principles) with *In re Laymon*, 117 B.R. 856 (Bankr.W.D.Tex. 1990), *rev'd.*, 958 F.2d 72 (5th Cir.

1992)(Federal judgment rate applies under § 506(b)); *In re Kelton*, 137 B.R. 19 (Bankr.W.D.Tex. 1992)(tax lien creditor entitled to federal judgment rate); *In re Laza*, 69 B.R. 669 (Bankr.E.D.N.Y. 1987)(market rate applies); *In re Anderson*, 28 B.R. 628 (S.D.Oh. 1982)(legal rate); *In re Brooks*, 24 B.R. 447 (Bankr.D.Kan. 1982)(market rate); *In re Marx*, 11 B.R. 819 (Bankr.S.D.Oh. 1981)(legal rate).

Decisions applying the contract rate fall into three major categories. A significant group of cases either assume that § 506(b) requires interest at the contract rate based upon the use of the term "agreement" in § 506(b), *In re Bates*, 58 B.R. 915 (Bankr.W.D.Tenn. 1986), or find that the contract rate should apply because § 506(b) does not expressly authorize modification of the contract rate, *In re Gladdin*, 107 B.R. 803 (Bankr.M.D.Ga. 1989). The decision of the Court of Appeals in the present case required application of the contract

rate based upon practice under the Bankruptcy Act, *Matter of Laymon*, 958 F.2d 72 (5th Cir. 1992). Finally, a third line holds that the contract rate should apply based upon practical and equitable considerations, *In re Loveridge Machine and Tool Company, Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983).

In this Petition for Writ of Certiorari, Petitioner will show that neither the statutory language of the Bankruptcy Code nor the historical practice under the Bankruptcy Act require application of the contract rate. Interest under § 506(b) is a matter of Federal law and does not require deference to state interest rates. The Federal judgment rate furnishes a measure of interest which is logical, practical and equitable, so that the Fifth Circuit erred in reversing the judgment of the District Court.

A. The Statutory Language Does Not Require the Contract Rate.

The task of interpreting a statute begins with the language of the statute itself. "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.'" *United States v. Ron Pair Enterprises, Inc.*, 109 S.Ct. at 1031.

In this case, two statutory sections are directly relevant to the interest paid to an oversecured creditor. 11 U.S.C. § 502(b)(2) provides that claims shall be allowed "except to the intent that such claim is for unmatured interest." § 502(b)(2) operates to displace contractual and statutory entitlements to interest outside of bankruptcy. Any right to post-petition interest must be provided for by the Bankruptcy Code itself, as opposed to the State law contract. However, § 502(b)(2) only disallows claims for "unmatured"

interest. Therefore, claims for interest accruing prior to bankruptcy are recognized based upon the contract or other applicable source.

There are two provisions of the Bankruptcy Code which allow interest during the period post-petition but prior to confirmation of a plan. 11 U.S.C. § 506(b) allows interest to an oversecured creditor, while 11 U.S.C. § 726(a)(5) allows interest at the legal rate to a creditor of a solvent Chapter 7 Estate.

The award of interest in this case is based upon § 506(b) which provides:

> (b) to the extent that an allowed secured claim secured by property the value of which, after any recovery under sub-section (c) of this Section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim,

> and any reasonable fees, costs, or charges provided for under the Agreement under such claim arose. (emphasis added).

While § 506(b) provides for interest to oversecured creditors, it does not state which rate is to be applied:

> However, it is the opinion of this Court that § 506(b) requires only that the oversecured creditor receive some rate of interest. It does not require that it receive the contract rate of interest, although it does require that the contract determine the allowable expenses and costs (emphasis in original).

In re Brooks, 24 B.R. 447, 449 (Bankr.D.Kan. 1982).

Some Courts have disagreed with this

analysis, holding that the phrase "interest on such claim" was part of the same phrase containing "any reasonable fees, costs, or charges provided for under the agreement under which such claim arose." Based upon this construction of the statute, these Courts concluded that § 506(b) required interest at the contract rate. *E.g., In re Bates*, 58 B.R. 915 (Bankr.W.D.Tenn. 1986); *Matter of Johnston*, 44 B.R. 667 (Bankr.W.D.Miss. 1984).

These cases are inconsistent with the Court's ruling in *Ron Pair Enterprises, Inc.*, in which this Court held that the phrase "interest on such claim" was independent of the statutory language referring to fees, costs or charges provided for under the agreement.

> This reading is also mandated by the grammatical structure of the statute. The phrase "interest on such claim" is set aside by commas, and separated

> from the reference to fees, costs and charges by the conjunctive words "and any." As a result, the phrase "interest on such claim" stands independent to the language that follows. "Interest on such claim" is not part of the list made up of "fees, costs or charges," nor is it joined to the following cause so that the final "provided for under the agreement," modifies it as well (citation omitted). The language and punctuation Congress used cannot be read in any other way. By the plain language of the statute, the two types of recovery are distinct.

United States v. Ron Pair Enterprises, Inc., 109 S. Ct. at 1030-31.

The Bankruptcy Court correctly relied upon *Ron Pair* to reject the cases which found that §

506(b) mandated interest at the contract rate.

Giving full effect to the Supreme Court's interpretation of that comma leads ineluctably to the conclusion that the entire issue of interest is completely divorced from either the existence or the content of any underlying agreement.

Case law prior to *Ron Pair* is of little assistance in resolving the issue, as most Courts confronting the rate question for consensual lienholders had settled on the contract rate by relying (explicitly or implicitly) on the statute's reference to "that amount provided for under the agreement under which such claim arose." (citations omitted). After *Ron Pair*, that logic is considerably less persuasive.

> Once the comma is given effect, leaping past it to the statute's reference to "the agreement" is no longer permissible.

In re Laymon, 117 B.R. at 858-59, A-40-41.

A related line of cases holds that because Congress did not specifically provide for modification of contractual interest rates in § 506(b), that Congress intended for such contracts to control. *In re Gladdin*, 107 B.R. 803 (Bankr.M.D.Ga. 1989); *In re Melbell Associates, Inc.*, 99 B.R. 31 (Bankr.E.D.Cal. 1989); *In re Skyler Ridge*, 80 B.R. 500 (Bankr.C.D.Cal. 1987) ("no authorization in § 506(b) to examine the reasonableness of the interest rate charged by the secured creditor").

The difficulty with these cases is that they presume that the Bankruptcy Code generally defers to contractual interest rates. In fact, the opposite is true. The Bankruptcy Code thoroughly regulates

and modifies recovery of interest in bankruptcy. § 502(b)(2) generally pre-empt rights to interest payable under state law. § 726(a)(5) allows interest to creditors of solvent bankruptcy Estates at the "legal rate." § § 1129(b), 1225(a)(5) and 1325(a)(5) all provide for interest under plans of reorganization to be paid at a market rate rather than a contract rate.

Interest at the contract rate is the exception rather than the rule and is limited to several narrow circumstances. First of all, under § 502(b)(2), matured, pre-petition interest is calculated at the contract rate. This is so because the statute pre-empts only "unmatured" interest.

Second, 11 U.S.C. § 1124(1) states that a claim is impaired unless the Chapter 11 plan "leaves unaltered the legal, equitable and contractual rights to which such claim or interest entitles the holder of such claim or interest."

Unimpaired classes of claims are not entitled to vote on a Chapter 11 plan and thus constitute a narrow subset of claims which may be treated under a Plan.

Finally, 11 U.S.C. § 1322(b)(2) provides that a Chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the Debtor's principle residence, ..." Once again, § 1322(b)(2) is a narrow exception to the treatment of claims in a Chapter 13 plan.

Thus, where Congress wished to leave State law interest entitlements intact, it was able to draft specific language to address specific situations. It is not reasonable to presume that Congress intended the contract rate when it used the term "interest." The Courts relying upon this interpretation essentially read the statute to provide for "interest under applicable non-bankruptcy law

on such claim."

However, this Court has recently warned against reading statutory terms more narrowly than they are written. In *Patterson v. Shumate*, ___ U.S. ____, 112 S.Ct. 2242 (1992), this Court reversed a holding that the term "applicable non-bankruptcy law" referred only to State spendthrift trust law and not to restrictions under ERISA. Similarly, in this case, it is not appropriate to read the term "interest" to mean "interest under applicable non-bankruptcy law."

The statutory text provides no basis for concluding that Congress mandated the contract rate. Therefore, it is necessary to turn to the historical analysis utilized by the Fifth Circuit.

B. Historical Analysis Does Not Require Application of the Contract Rate.

In reversing the lower Courts, the Fifth Circuit did not adopt the prevalent analysis that the

statutory language of § 506(b) requires application of the contract rate. Rather, the Fifth Circuit held that practice under the Bankruptcy Act required this result.

> Even though we hold *Ron Pair* does not affect the rate of interest applied in § 506(b), we still must determine what rate of interest applies in this case. The Supreme Court "has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, __ U.S.___, 112 S.Ct. 773, 779, 116 L.Ed.2d 903 (1992). The legislative history of §

> 506(b) does not refer to a rate of interest. (citation omitted). The language of § 506(b) does not refer to a rate of interest. See 11 U.S.C. § 506(b). Therefore, we must conclude that Congress did not intend for § 506(b) of the Code to effect a major change in pre-Code practice concerning the rate of interest applied under the Section. (citation omitted).

Matter of Laymon, 958 F.2d at 74; A-12 to 13.

The Fifth Circuit went on to state that "Prior to the enactment of the Code, the majority of Courts utilized the contract rate of interest when allowing an oversecured creditor to collect post-petition interest pursuant to § 506(b)." 958 F.2d at 75; A-14. The Fifth Circuit based this statement on a treatise which it cited. Based upon this interpretation of pre-Code practice, the Fifth Circuit

required that post-petition interest be calculated at the contract rate.

Intent to codify practice under the Bankruptcy Act does not furnish a basis for applying the contract rate in this case. The Fifth Circuit relied upon a presumption that Congress would not change practice under the Act without making a statement in the legislative history. However, in *Ron Pair*, this Court warned against reading too much into omissions from legislative history, stating:

> Initially, it is worth recalling that Congress worked on the formulation of the Code for nearly a decade. It was intended to modernize the Bankruptcy laws (citation omitted), and as a result made significant changes in both substantive and procedural laws of Bankruptcy. (citation omitted). In

> particular, Congress intended "significant changes from current law in... the treatment of secured creditors and secured claims." In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took.

United States v. Ron Pair Enterprises, Inc., 109 S.Ct. at 1030.

There are three principal reasons not to rely upon the Fifth Circuit's historical analysis in this case. First, it is clear that in adopting § 506(b), Congress made several changes to practice under the Bankruptcy Act which are not discusssed in the legislative history. The existence of such changes rebuts the presumption that Congress would have documented any changes it intended to make. Second, Act decisions concerning interest rates to

oversecured creditors were not uniform and are not helpful in light of the distinctions between the Code and the Act. Finally, a per se rule applying the contract rate is inconsistent with the overall structure of the Bankruptcy Code.

The legislative history to § 506(b) is not extensive. The House Report states:

> Subsection (b) codifies current law by entitling a creditor with an oversecured claim to any reasonable fees, costs or charges provided under the agreement under which the claim arose. These fees, costs and charges are secured claims to the extent that the value of the collateral exceeds the amount of the underlying claim.

H.R.Rep.No. 595, 95th Cong., 1st Sess., 356-57 (1977), 1978 U.S.Code Cong.&Admin.News 5787, 6312. The legislative history does not discuss

interest on oversecured claims. The fact that fees, costs and charges provided for under the agreement are discussed separately appears to confirm the holding in *Ron Pair* that interest is a separate form of recovery from fees, costs and charges.

§ 506(b) modified, clarified and altered practice under the Bankruptcy Act in several respects which are not discussed above. Under the Act, there was a split of authority as to whether oversecured creditors were entitled to interest as a matter of right. One line of cases recognized three circumstances in which post-petition interest would be allowed, including when the security for a claim was worth more than the amount of the claim. *United States v. Bass*, 271 F.2d 129 (9th Cir. 1959). However, a second line of cases allowed interest to oversecured creditors only where it was equitable to do so, there was a solvent estate or the interest was paid out of income generated from the property.

Smith v. Robinson, 343 F.2d 793 (4th Cir. 1965); *United States v. Harrington*, 269 F.2d 719 (4th Cir. 1959); *Beecher v. Leavenworth State Bank*, 192 F.2d 10 (9th Cir. 1951); *In re Leed's Homes, Inc.*, 222 F.Supp.20, 33-34 (E.D.Tenn. 1963). Indeed, the *Beecher* case went so far as to state that the exception allowing interest to oversecured creditors had been repudiated by the Supreme Court in *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946). The Fifth Circuit has stated that an oversecured creditor's right to interest under the Bankruptcy Act depended "on the equities on the situation." *In re Timbers of Inwood Forest, Ltd.*, 793 F.2d 1380, 1386 (5th Cir. 1986).

Under the Act, it was not clear that oversecured creditors were entitled to post-petition interest. When the Bankruptcy Code was adopted, § 506(b) clearly provided for post-petition interest to

oversecured creditors. However, this change is not mentioned in the legislative history.

Another line of cases allowed post-petition interest to oversecured creditors holding consensual liens but denied post-petition interest to holders of statutory liens. *United States v. Harrington*, 269 F.2d at 722-23; *United States v. Bass*, 271 F.2d 129 (9th Cir. 1959); *In re Kerber Packing Company*, 276 F.2d 245 (7th Cir. 1960); *In re Boston and Maine Corp.*, 719 F.2d 493 (1st Cir. 1983), *cert. den. sub nom. City of Cambridge v. Meserve*, 466 U.S. 938 (1984); *State Board of Equalization v. Stodd*, 500 F.2d 1208 (9th Cir. 1974). In *Ron Pair*, this Court held that the statutory language of § 506(b) allowed interest to oversecured statutory lien creditors, even though the legislative history did not address this change.

Additionally, under the Act, it was frequently held that recovery of attorney's fees by secured

creditors was governed by State law and that the provisions of the Bankruptcy Act with respect to attorney's fees did not apply. *Security Mortgage Company v. Powers*, 278 U.S. 149, 49 S.Ct. 84, 73 L.Ed. 236 (1928); *In re Continental Vending Machine Corp.*, 543 F.2d 986 (2nd Cir. 1976); *In re Crafty Fox Limited*, 475 F.Supp. 634 (W.D.Va. 1979); *In re Holiday Mart, Inc.*, 9 B.R. 99 (Bankr.D.Hawaii 1981). But see, *First Savings Bank and Trust Company v. Stuppi*, 2 F.2d 822 (8th Cir. 1924)(Bankruptcy Court could fix reasonable fees.) Under the Bankruptcy Code, it is now recognized that recovery of attorney's fees by a secured creditor is a matter of Federal law and that creditors must prove reasonableness even if this is not required by State law. *In re Hudson Shipbuilders, Inc.*, 794 F.2d 1051 (5th Cir. 1986). The change with respect to attorney's fees is particularly significant due to the fact that the legislative history which does exist for

§ 506(b) specifically states an intent to codify prior law. However, despite this legislative history, the Courts have followed the language of the statute to effect a change in pre-Code practice.

It is clear that § 506(b) changed more than was addressed in its legislative history. Therefore, it would be a mistake to place too much emphasis on any particular omission from the legislative history. This is particularly so because the practice of awarding interest at the contract rate to oversecured creditors provides a poor model to follow in the first place.

In *Matter of Laymon*, the Fifth Circuit cited a treatise for the proposition that prior to enactment of the Code, the majority of Courts utilized the contract rate of interest on oversecured claims. 3 Collier on Bankruptcy, para. 506.05, at 506-46. Collier on Bankruptcy, in turn, cited to five cases under the Act and one case under the Code.

Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed.162 (1946); *Sexton v. Dreyfus*, 219 U.S. 339, 31 S.Ct. 256, 55 L.Ed. 244 (1911); *In re Black Ranches, Inc.*, 362 F.2d 8 (8th Cir.), *cert. den.*, 385 U.S. 990 (1966); *In re Magnus Harmonica Corp.*, 262 F.2d 515 (3rd Cir. 1958); *Weeks v. McInnis*, 200 F.2d 611 (6th Cir. 1952), *cert. den.*, 345 U.S. 958 (1953); and *In re United Merchants and Manufacturers, Inc.*, 674 F.2d 134 (2nd Cir. 1982). However, none of these cases dealt with the rate of interest to an oversecured creditor. Each of the Act cases cited dealt with allowability of certain types of interest rather than the rates to be paid. The Code case cited dealt with recovery of attorney's fees.

Most cases under the Act did not directly address the proper rate of interest to be paid to a secured creditor. As stated above, some Courts denied post-petition interest to secured creditors

entirely unless it was consistent with equitable principles. *Smith v. Robinson*; *Beecher v. Leavenworth State Bank*. Several cases specifically required payment of the contract rate. *United States v. Sampsell*, 153 F.2d 731 (9th Cir. 1946); *In re International Raw Material Corporation*, 22 F.2d 920 (2nd Cir. 1927); *San Antonio Loan & Trust Co. v. Booth*, 2 F.2d 590 (5th Cir. 1924); *Matter of Schrader Body, Inc.*, 315 F.Supp. 1349 (W.D.Penn. 1970); *In re Stevens*, 173 F. 842 (D.Ore. 1909). On the other hand, some Courts limited interest rates. *Levin v. Johnson*, 7 F.2d 885 (7th Cir. 1925)(reducing interest from 40% to 7% despite absence of corporate usury statute); *Richter v. Goetz*, 253 F. 938 (7th Cir. 1918)(limiting interest on purchased tax claims to 6%).

The courts which explicitly required application of the contract rate did so for reasons which are inconsistent with the present Bankruptcy

Code. Under the Bankruptcy Act of 1898, § 67d (11 U.S.C. § 107 (repealed)) prevented a Court from modifying a lien. This was the basis for the rulings in *Sampsell*, *International Raw Material*, *San Antonio Loan & Trust Co.* and *Stevens*. However, this is specifically not the case under the Bankruptcy Code. The Bankruptcy Code allows liens to be modified in numerous circumstances. See § § 506(b) (denying interest to undersecured lien creditors); 522(f), 544, 545, 547, 548, and 549 (avoiding liens); 722 (allowing redemption for value); 724 (subordinating tax liens); 1129(b), 1225(a)(5) and 1325(a)(5) (allowing modification of interest rate on secured claims). In each of these circumstances, liens may be avoided, striped down or have their interest rates modified.

In the *Schrader Body* case, the Court cited an unwillingness to change the terms of the valid and subsisting contracts. However, the Bankruptcy

Code modifies contracts in many respects, including post-petition interest.

As discussed more fully above, the legislative history and practice under the Act should be weighed against the structure of the Bankruptcy Code. The Bankruptcy Code thoroughly regulates interest accruing post-petition. The instances in which the Code permits a contract rate to apply post-petition are specific and limited.

Thus, the Fifth Circuit erred when it relied upon the legislative history and the practice under the Bankruptcy Act to determine that the contract rate was required.

C. Selecting a Federal Interest Rate.

§ 506(b) does not specify an interest rate to be applied to oversecured claims. The legislative history is silent as well. Therefore, Bankruptcy Courts are given discretion to select an appropriate interest rate consistent with common law and the

principles of the Bankruptcy Code. The Bankruptcy Court in this case reviewed the precedents of the Supreme Court and other Courts with respect to interest in Bankruptcy and reviewed the structure of the Bankruptcy Code to determine that the Federal judgment rate was an appropriate rate to apply in the present case. This determination was correct and should have been affirmed.

The federal courts have extensive experience in awarding interest in bankruptcy. The Sixth Circuit summarized this experience, stating:

> The reorganization court must consider whether to grant post-petition interest, not as an abstract matter, but in light of the nature of each claim and the equities of the case before it. At all times, the reorganization court must be guided by the basic principle announced in *Vanston Bondholders*

Protective Committee v. Green (citation omitted):

> It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balancing of the equities between creditor and creditor or between creditors and the debtor.

In re Kentucky Lumber Company, 860 F.2d 674, 677 (6th Cir. 1988).

Several principles apply to recovery of post-petition interest. Awards of post-petition interest are a matter within the discretion of the Federal court and arise under Federal law. In *Vanston Bondholders Protective Committee v. Green*, the Supreme Court stated that, "When and under what circumstances Federal courts will allow interest on claims against Debtors' estates being administered

by them has long been decided by Federal law." 67 S.Ct. at 240.

The First Circuit has stated that interest in bankruptcy is awarded based upon the intervention of Federal law.

> (1) Interest is a penalty or damages assessed for detention of money by the Debtor, so it is not appropriate to assess that penalty against other creditors who are not to blame for the detention.
>
> (2) It is the Court, not the debtor, that is doing the "detaining" post-petition.

Debenture Holders Protective Committee v. Continental Investment Corp., 679 F.2d 264, 269 (1st Cir. 1982), *cert. den'd.* 459 U.S. 894.

Relying upon these precedents, the Bankruptcy Court stated:

> The justification for interest, if it is to be paid at all, is in compensation for the detention of money occasioned by the Bankruptcy case itself, a detention visited equally on all creditors of the bankruptcy estate by a process operating under the exclusive auspices of the Federal judicial system, and a detention not directly related to the pre-petition agreements the debtor struck with its creditors. The obligation is the bankruptcy estate's, not the debtor's.

In re Laymon, 117 B.R. at 860; A-48.

Although the contract rate has little significance under federal law, the judgment rate does. A judgment in an adversary proceeding in bankruptcy bears interest at the Federal judgment rate. *In re Southern Indus. Banking Corp.*, 87 B.R.

518 (Bankr. E.D. Tenn. 1988); *In re Goldblatt Brothers.*, 61 B.R. 459 (Bankr. N.D. Ill. 1986). An allowed claim in bankruptcy is similar to "a Federal judgment against estate assets enforcible only in Federal court." *In re Laymon*, 117 B.R. at 862; A-57.

The Federal judgment rate also applies under 11 U.S.C. § 726(a)(5). § 726(a)(5) provides that creditors of a solvent Chapter 7 Estate are entitled to receive interest at the "legal rate." The legal rate is the Federal judgment rate under 28 U.S.C. § 1961(a). *In re Godsey*, 134 B.R. 865 (Bankr. M.D. Tenn. 1991). § 726(a)(5) is the other section of the Bankruptcy Code which authorizes recovery of interest post-petition but prior to confirmation of a plan of reorganization. Therefore, it is logical to look to § 726(a)(5) to interpret § 506(b).

The underlying purpose of any bankruptcy system is the ratable, equitable distribution of

assets among creditors of the estate.

The Bankruptcy Court in this case stated:

> The general purpose of a bankruptcy statute is the equitable distribution of the debtor's assets among the debtor's creditors. (citation omitted). A number of significant consequences flow from this simple statement of the obvious. First, bankruptcy statutes should be interpreted to give effect to this underlying principle. Second, all similarly situated creditors should be similarly treated. Third, creditors should not be preferred absent special legal or equitable considerations warranting preferential treatment.

In re Laymon, 117 B.R. at 861; A-50-51.

In applying these principles to § 506(b), the Bankruptcy Court properly concluded that the

Federal judgment rate was an appropriate rate to apply. The Bankruptcy Court stated that, "The interest contemplated under § 506(b) is most sensibly construed as an equitable award arising under Federal law to compensate the oversecured creditor for the delay caused by the Bankruptcy case itself." 117 B.R. at 863; A-61. The Court went on to state that:

> The principle of equitable, ratable distribution of assets among creditors also lends support to the use of the Federal rate in computing § 506(b) interest awards. Any equity over and above the creditor's allowed secured claim belongs to the general pool of assets available to unsecured creditors. The competition for this asset is not between creditors and the debtor but between two different groups of

creditors, secured and unsecured. The use of the Federal judgment rate gives effect to Congress' intent that secured creditors have a "first claim" on that excess collateral value to compensate it for the bankruptcy delay. At the same time, it prevents overreaching by the oversecured creditor. (citations omitted). . . . Because the rationale for paying post-petition interest is to compensate for the delay imposed by the bankruptcy process (which delay is visited equally on all creditors), there is little justification for making unsecured creditors pay the secured creditor a rate of interest derived from a pre-petition agreement to which they were not a party. Use of the Federal rate yields an equitable solution to the

> competing claims of the secured and unsecured creditor that also honors the principle of applying Federal law to the payment of post-petition interest (citation omitted).

In re Laymon, 117 B.R. at 863-64; A-61 to 64.

The Federal judgment rate also has practical and equitable grounds to recommend it. The Federal judgment rate is an uniform rate which is set by an impartial authority. The Federal judgment rate is based upon the yield on 52 week treasury bills. The rate is determined by the Secretary of the Treasury and is distributed by the Director of the Administration Office of the United States Courts. Because the Federal judgment rate is based upon the auction price of 52-week T Bills, it is responsive to market forces and relates directly to the return an investor could obtain upon his money on a risk free investment. The rate of return

for a risk-free investment is an appropriate comparison for a creditor holding an oversecured claim.

It is also important to note that the contest in the present case is between a Chapter 11 Trustee, who is charged with obtaining the best return for the unsecured creditors, and a secured creditor, who was not satisfied with a 10% return and sought to extract an eighteen (18) percent penalty interest rate against the Estate's assets. The Federal judgment rate represents a fair compromise between the competing interests of the unsecured creditors and the secured creditor in this case.

Petitioner has located one other case which discussed interest rates under § 506(b) as a matter of Federal common law. *In re Loveridge Machine & Tool Company, Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983). In that case, the Court found that the contract rate should apply in cases in which there

is a contract based upon the following analysis:

> An interest rate should not be chosen by juggling rules of grammar. Neither should the selection of an interest rate be influenced by favoritism of debtors over creditors, creditors over debtors, or of some creditors over others. Using the lawful contract rate where there is a contract avoids such errors and provides a rule which is easily applied and consistent with authority and reason.
>
> Using any interest rate other than the contract rate, where there is a contract, would produce irrational results. To measure the reasonable fees, costs, and charges to be added to an allowed oversecured claim based on a contract, the court would look to the

contract. But to measure the interest to be added to the same claim, the Court would look outside the contract. Why should bankruptcy law enforce the parties' bargain with respect to fees, costs, and charges but not enforce it with respect to interest?...(R)ejecting the contract rate where there is a contract might mean either a windfall to the creditor when the contract rate is less than the rate selected or a windfall to the debtor when the contract rate exceeds the rate selected. Given the volatility of interest rates, contract rate will often differ from the prevailing market rate at the time of the hearing. The parties in this case have shown no good reason for producing a windfall under § 506(b).

In re Loveridge Machine & Tool Company, Inc., at 162 -63.

The Court in *Loveridge* identified some important factors. However, those factors tend to support the Federal judgment rate rather than the contract rate. First, the *Loveridge* court stated that selection of an interest rate should avoid favoritism among creditors and the Debtor. Applying an interest rate negotiated by the Debtor and the secured creditor pre-petition allows the Debtor to favor preferred creditors as against the body of creditors at large. Therefore, avoiding favoritism is best served by applying an uniform, national rate of interest.

Second, the *Loveridge* Court suggested that it would be irrational to look to the contract to determine fees, costs and charges but not to determine interest. However, the contract only determines whether fees, costs and charges will be

allowed. It does not define the rate at which such fees, costs and charges will be paid. Fees, costs and charges must be approved as reasonable under Federal law. *In re Hudson Shipbuilders, Inc.*, 794 F.2d 1051 (5th Cir. 1986); *In re Wonder Corp. of America*, 72 B.R. 580 (Bankr.D.Conn. 1987).

Next, the Utah Bankruptcy Judge stated that applying the contract rate would avoid a windfall in cases where there was a difference between contract and market rates. In fact, the contrary is true. Awarding a secured creditor an above market rate based upon a pre-petition contract results in a windfall to the secured creditor. Under a plan of reorganization, the secured creditor is only entitled to recover a market interest rate. There is no reason why a secured creditor should retain this advantage during the period between filing of the petition and confirmation of the plan. Such an advantage will only encourage secured creditors to

delay proceedings in order to retain their above market rates.

The factors applied by the Court in *Loveridge* do not support a mechanical application of the contract rate. Avoiding favoritism, consistency in statutory analysis and preventing windfalls are best served by applying federal rather than state law.

CONCLUSION

Interest under 11 U.S.C. § 506(b) is a matter of Federal law. Neither the statutory language, the legislative history nor practice under the Bankruptcy Act require application of the contract rate. Bankruptcy Courts should be allowed to select an appropriate Federal interest rate on a case by case basis.

The Bankruptcy Court did not abuse its discretion in selecting the Federal judgment rate in the present case. The Federal judgment rate is an uniform, market based rate and represents a fair

compromise between the interests of the secured creditor and the unsecured creditors. The secured creditor has not demonstrated any equities which would make it unfair to apply the Federal judgment rate. Indeed, the secured creditor has received post-petition payments of over $600,000.00 during this case. These payments, which would otherwise have been available for unsecured creditors, are approximately equal to the original principal amount of the claim.

Because the Bankruptcy Court ruled properly in selecting the interest rate, Petitioner requests that this Court grant the Petition for Writ of Certiorari, and that upon granting the Writ that the Judgment of the Fifth Circuit be reversed and the Order of the District Court be reinstated.

Respectfully submitted,

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